

## Message Text

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ORIGIN ARA-10

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DRAFTED BY ARA/AND:DKEMP:LJ  
APPROVED BY ARA:JBUSHNELL  
EB/ORF/FSE:WMILAM (DRAFT)  
TREASURY:FMARESCA (DRAFT)  
ARA/ECP:SHROGERS (DRAFT)  
ARA/AND:MBARNEBEY (DRAFT)  
LA/SA:RWEBER (DRAFT)  
NSC:RPASTOR (SUBS)  
S/P:PKREISBERG (DRAFT)

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FM SECSTATE WASHDC  
TO AMEMBASSY LIMA IMMEDIATE

C O N F I D E N T I A L STATE 091084

LIMDIS

E.O. 11652: GDS

TAGS: EFIN, PE, MASS

SUBJECT: PERU'S FINANCIAL CRISIS - APPROACH BY AMBASSADOR

REF: LIMA 2943

1. SUMMARY. PERUVIAN AMBASSADOR GARCIA BEDOYA MET WITH  
DEPUTY ASSISTANT SECRETARY BUSHNELL ON APRIL 7 TO PRESENT  
A LETTER FROM PRESIDENT MORALES BERMUDEZ TO PRESIDENT  
CARTER ASKING THE LATTER TO MEET WITH HIS FOREIGN AND  
FINANCE MINISTERS IN THE NEAR FUTURE CONCERNING PERU'S  
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ECONOMIC CRISIS AND NEGOTIATIONS WITH THE IMF. BUSHNELL  
PRESENTED THE U.S. POSITION ON THE PERUVIAN DIFFICULTIES  
IN FIVE POINTS: A. THE U.S. IS SYMPATHETIC IN VIEW OF  
PERU'S HUMAN RIGHTS AND DEMOCRATIZATION POLICIES AND WILL  
MAKE UNUSUAL EFFORTS TO BE SUPPORTIVE; B. THE GOP MUST  
FIRST ACHIEVE AN AGREEMENT WITH THE IMF; C. IF NECESSARY,  
THE U.S. IS WILLING TO RESCHEDULE PERUVIAN OFFICIAL DEBT  
IN CONJUNCTION WITH OTHER CREDITORS; D. AUSTERITY  
IS NEEDED BY ALL SECTORS GOP INCLUDING MILITARY: MORE-  
OVER, LARGE SUBMARINE PURCHASE MAKES U.S. RESPONSE

MORE DIFFICULT AS WELL AS COMPOUNDING PROBLEMS OF DEBT REPAYMENT IN EARLY 1980'; E. IT IS UNLIKELY THAT PRESIDENT CARTER WILL BE ABLE TO RECEIVE THE MINISTERS, BUT FOLLOWING AN IMF ACCOMODATION EVERY

EFFORT WOULD BE MADE TO ARRANGE MEETINGS WITH SECRETARIES OF STATE AND/OR TREASURY. PRESIDENTIAL LETTER PRESENTED BY GARCIA BEDOYA IS BEING TRANSMITTED TO EMBASSY IN SEPTEL. END SUMMARY.

2. IN MEETING WITH BUSHNELL (ROGERS-ECP, AND KEMP-ARA/AND, ALSO IN ATTENDANCE) GARCIA BEDOYA STATED THAT GOP HAS THREE MAJOR ECONOMIC PROBLEMS: A. MEANS OF ACCOMMODATION WITH THE IMF STAND-BY AGREEMENT; B. MANAGEMENT OF THE SHORT-TERM BALANCE OF PAYMENTS (APPARENTLY CASH SQUEEZE) BETWEEN NOW AND JUNE; C. RE-STRUCTURING ITS DEBT. HE SAID PRESIDENT WISHES TO SEND MINISTERS DE LA PUENTE AND SAENZ TO WASHINGTON TO DISCUSS THESE TOPICS. GARCIA BEDOYA SAID THAT IN VIEW OF WORSENING ECONOMIC PROBLEMS THE GOP IS WORRIED ABOUT MEETING PRESENT CONSTITUTIONALIZATION SCHEDULE. CONVOCAION OF THE CONSTITUENT ASSEMBLY, HE NOTED, WOULD MOST LIKELY SEE THAT BODY DELIBERATING THE WHOLE RANGE OF PERUVIAN CONFIDENTIAL

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ISSUES, ESPECIALLY THE ECONOMIC SITUATION, RATHER THAN CONSTITUTIONAL REVISION.

3. BUSHNELL INFORMED GARCIA BEDOYA THAT ON BASIS AMBASSADOR SHLAUDEMAN'S APRIL 5 MEETING WITH DE LA PUENTE DISCUSSIONS HAD TAKEN PLACE WITHIN DEPTMENT AND WITH TREASURY AND WHITE HOUSE. HE COULD NOW STATE U.S. POSITION ON VARIOUS ASPECTS PERUVIAN SITUATION. BUSHNELL MADE FIVE POINTS:

A. THE USG IS PLEASED WITH THE POSITIVE HUMAN RIGHTS RECORD OF THE GOP AND WELCOMES STEPS BEING TAKEN TO RETURN THE COUNTRY TO REPRESENTATIVE CONSTITUTIONAL RULE. WE RECOGNIZE THAT THESE GOALS ARE MORE DIFFICULT TO ACHIEVE WHEN ECONOMIC PROBLEMS INTERVENE AND WE HAVE BEEN AND WILL CONTINUE TO BE SUPPORTIVE. WE ARE READY TO TAKE UNUSUAL STEPS TO HELP PERU IN THIS PROCESS BUT CANNOT DO THE IMPOSSIBLE.

B. PRELIMINARY TO ANY OTHER EFFORTS THE GOP MUST WORK OUT AN ACCEPTABLE PROGRAM WITH THE IMF. THE USG HAS ALWAYS SUPPORTED THE IMF AND CANNOT NOW APPEAR TO UNDERCUT THAT BODY. THIS HAS BEEN A DIFFICULT ISSUE IN THE PAST BETWEEN OUR GOVERNMENT AND OTHERS, BUT WE NOTE THAT TURKEY HAS JUST CONCLUDED AN AGREEMENT WITH THE FUND AND PORTUGUESE NEGOTIATIONS ARE GOING WELL. IT IS IMPORTANT THAT A BASIC ECONOMIC PROGRAM

BE ENDORSED BY THE IMF STAFF BEFORE THE FOREIGN AND  
FINANCE MINISTERS MEET WITH U.S. OFFICIALS IN WASHINGTON  
IF DISCUSSIONS ARE TO BE PRODUCTIVE. LACK OF IMF  
SUPPORTED PROGRAM AT TIME OF HIGH-LEVEL DISCUSSIONS

COULD RESULT IN SUCH MEETING BEING SEEN AS FAILURE  
BECAUSE THERE WOULD NOT BE POSITIVE PROGRAM ANNOUNCED.  
SUCH PERCEIVED FAILURE COULD HAVE LASTING NEGATIVE  
EFFECT IN FINANCIAL COMMUNITY IN U.S. AND PERU AS  
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WELL AS POLITICAL RAMIFICATIONS.

C. IF ACCOMMODATION CAN BE REACHED WITH THE FUND,  
THE USG IS PREPARED TO EXAMINE DEBT RESCHEDULING IF IT  
IS DESIRED AND NEEDED. NOTING THAT AMBASSADOR SHALAUDEMAN  
AND THE FOREIGN MINISTER HAD DISCUSSED SPECIFICS OF  
RESCHEDULING, BUSHNELL PROCEEDED TO MAKE CLEAR BASIC  
REQUIREMENTS WHICH U.S. AND OTHER CREDITORS WOULD  
MOST LIKELY INSIST UPON WOULD INCLUDE A PROGRAM WITH  
THE IMF, PROVISION THAT NON-PARTICIPATING CREDITOR  
COUNTRIES SUCH AS THE USSR NOT RECEIVE MORE FAVORABLE  
TREATMENT, AND NEGOTIATION OF COMPARABLE AGREEMENTS  
WITH THE PRIVATE COMMERCIAL BANKS. HE NOTED THAT THERE  
IS NO PRECEDENT FOR THE IDB OR WORLD BANK TO RESCHEDULE  
DEBT. CARE SHOULD BE TAKEN IN EXAMINING THE EFFECT  
OF RESCHEDULING ON NEW CREDIT FLOWS, MANY GOVERNMENT  
AGENCIES PROVIDING SHORT AND MEDIUM-TERM CREDITS CUTBACK  
OR DISCONTINUE NEW CREDITS AND GUARANTEES UNDER SUCH  
CONDITIONS (I.E., THE EXIM BANK). ON OTHER HAND SOUND  
ECONOMIC PROGRAM WITH RESCHEDULING CAN GIVE INCREASED  
CONFIDENCE TO LONGER TERM LENDERS. HE PERSONALLY THOUGHT  
THE GOP SHOULD INCLUDE IN THE OPTIONS IT CONSIDERS  
A "SELECTIVE" RESCHEDULING (CONFINED TO REFINANCING  
OF CERTAIN TYPES OF DEBT) AS OPPOSED TO "GENERAL"  
RESCHEDULING. BUSHNELL, AGAIN EXPRESSING A PERSONAL  
VIEW, SAID THAT WHILE A THREE-YEAR RESCHEDULING WOULD  
OBVIOUSLY BE ADVANTAGEOUS, THERE WAS NO PRECEDENT  
FOR IT IN A CRISIS SITUATION LIKE PERU'S. PUBLIC AND  
PRIVATE CREDITORS WOULD LIKELY INSIST ON KEEPING A  
TIGHT REIN, REQUIRING A ONE-YEAR LIMIT SO THE PROGRESS  
OF THE UNDERLYING ECONOMIC PROGRAM COULD BE RE-EXAMINED  
PRIOR TO FURTHER RESCHEDULING.

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D. BUSHNELL SAID HE WISHED TO SPEAK FRANKLY AMONG  
FRIENDS ABOUT ANOTHER ASPECT. WE ARE VERY CONCERNED  
ABOUT THE LEVEL AND NATURE OF GOP MILITARY PROGRAMS;  
LACK OF PARTICIPATION OF ANY SECTOR OF SOCIETY IN

AN AUSTERITY PROGRAM MAKES IT HARDER FOR THE REST. THE SUBSTANTIAL PURCHASE OF GERMAN SUBMARINES WOULD MAKE RESOLVING THE SHORT-TERM PROBLEM MORE DIFFICULT. AMORTIZATION OF THE GERMAN SUBMARINES WOULD (UNDER GOP PROPOSAL) COME DUE IN EARLY 1980'S AT SAME TIME AS RESCHEDULED AMORTIZATIONS AND THOSE ORIGINALLY SCHEDULED FOR THOSE YEARS, THUS MAKING THE PERUVIAN DEBT SERVICE SITUATION AGAIN MORE DIFFICULT. SUCH

PURCHASES WOULD BE DIFFICULT FOR US AND OTHER CREDITORS TO EXPLAIN AND COULD COMPLICATE AND RESTRAIN EFFORTS TO BE SUPPORTIVE. CREDITORS AND CRITICS MUST BE CONVINCED THEY ARE ENGAGING IN A PROGRAM OF LONG-TERM DEVELOPMENT OF PERU'S ECONOMY AND NOT OF ITS MILITARY ESTABLISHMENT. HE ASSURED GARCIA BEDOYA THAT WE DID NOT CONSIDER THE SUBMARINE PURCHASE A BREACH OF THE AUGUST MORATORIUM ON NEW ARMS ACQUISITIONS. OUR CONCERN IS THE ECONOMIC IMPACT OF THESE AND PREVIOUS PURCHASES AND THE LACK OF MILITARY AUSTERITY IN OTHER RESPECTS.

THE AMBASSADOR DESCRIBED THE SUBMARINE PURCHASE AS ONE REQUIRED TO REPLACE OBSOLETE VESSELS AND NOTED FIRST DELIVERY WOULD NOT BE MADE UNTIL 1981. HE SAID THAT THE CONTRADICTION IN PRIORITIES WAS MORE APPARENT THAN REAL SINCE THE CHILEAN NAVAL COMMANDER HAD RECENTLY CLAIMED THAT CHILE'S MILITARY POSITION WAS SUPERIOR TO WHAT IT HAD BEEN IN 1879. BUSHNELL, AFTER STATING HIS OWN UNDERSTANDING OF THE UNDERLYING PROBLEM, SUGGESTED THAT PURCHASES FROM THE USSR HAD MOVED PERU INTO A FAVORABLE POSITION IN RELATION TO GROUND AND AIR DEFENSES AND MANY PEOPLE WOULD NOT ACCEPT THE NEED FOR FURTHER PURCHASES IN THIS TIMEFRAME.  
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E. BUSHNELL TOLD GARCIA BEDOYA THAT EVEN AFTER AN IMF PROGRAM HAS BEEN NEGOTIATED, HE THOUGHT IT WAS UNLIKELY THAT THE PRESIDENT, WHO ALREADY HAS A OVERLY FULL SCHEDULE, WOULD BE ABLE TO SEE THE MINISTERS. SECRETARY VANCE, HE NOTED, WILL BE TRAVELLING ABROAD TWO OR THREE TIMES DURING THE NEXT MONTH AND SECRETARY BLUMENTHAL WILL ALSO BE OUT OF THE COUNTRY AT INTERVALS. THEREFORE IT WOULD BE DIFFICULT TO FIND DATES WHEN BOTH SECRETARIES WOULD BE AVAILABLE. NEVERTHELESS, WHEN AN ARRANGEMENT HAS BEEN ACHIEVED WITH THE IMF, EVERY ATTEMPT WILL BE MADE TO SCHEDULE MEETINGS WITH THE SECRETARIES AND FAILING THAT, MEETINGS WITH SENIOR OFFICIALS FULLY INVOLVED IN THE PROBLEM. SINCE GARCIA BEDOYA SAID THAT THE VISIT IS NOT BEING PROJETED BEFORE APRIL 20, BUSHNELL SUGGESTED THAT IT WOULD BE USEFUL TO ADVANCE TECHNICAL-LEVEL DISCUSSIONS BETWEEN THE U.S. AND PERU DURING THE INTERVAL SO THAT OPTIONS COULD BE CLEARLY FORMULATED FOR U.S. CABINET LEVEL.

4. THE PERUVIAN AMBASSADOR, TURNING BACK TO THE QUESTION OF ACCOMMODATION WITH THE FUND, STATED THAT THE GOP'S NEW AUSTERITY MEASURES MIGHT BE READY THE WEEK OF APRIL 10. HIS GOVERNMENT, HE SAID, WILL TAKE NEW MEASURES, EVEN THOUGH THEY COMPLICATE THE SOCIAL SITUATION, BUT THESE MAY NOT BE ALL THE IMF DESIRES. BUSHNELL SAID WE

WERE ENCOURAGED BY INFORMATION THAT NEW MEASURES WOULD BE TAKEN SINCE MEASURES IMPLEMENTED TO DATE CLEARLY HAD NOT BEEN SUFFICIENT. HE SUGGESTED FROM 20 YEARS EXPERIENCE WITH THE IMF THAT IF THE BASIC ELEMENTS OF AN ECONOMIC PROGRAM WERE AGREED, IT WOULD BE POSSIBLE TO NEGOTIATE IMF AGREEMENT SPECIFICS QUICKLY.  
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5. GARCIA BEDOYA WAS PESSIMISTIC ABOUT A RAPID AGREEMENT WITH THE IMF AND ASKED WHAT COULD BE DONE IMMEDIATELY. BUSHNELL STATED THAT UNTIL AN AGREEMENT WAS WORKED OUT WITH IMF, EVERYONE WOULD HOLD BACK AND THE SHORT-TERM SITUATION WOULD WORSEN. GARCIA BEDOYA SUGGESTED POSSIBILITY OF A DECLARATION BY THE FUND THAT THE PERUVIAN PROPOSALS WERE APPROPRIATE AND WOULD BE NEGOTIATED, BUT BUSHNELL THOUGHT THAT STAFF AGREEMENT ON A PROGRAM TO BE SUBMITTED TO THE BOARD FOR APPROVAL WOULD BE THE MINIMUM REQUIRED FOR OTHERS TO BE GALVANIZED. BUSHNELL RECOGNIZED THAT IT WAS NOT LIKELY THAT PERU COULD ACHIEVE COMPLIANCE WITH THE EXISTING AGREEMENT. BUT HE THOUGHT IT ENTIRELY POSSIBLE THAT SOME ACCOMMODATION COULD BE REACHED IN COUPLE OF WEEKS RATHER THAN MONTHS. SINCE PERSONALITY PROBLEMS WITH THE FUND HAVE NOW BEEN WORKED OUT, SUBSTANTIVE DISCUSSIONS CAN MOVE RAPIDLY. NO FACT FINDING MISSION WOULD BE NECESSARY AND WITH A GOP PROGRAM SATISFYING MAJOR ELEMENTS, NEGOTIATIONS COULD MOVE VERY RAPIDLY.

6. BUSHNELL INFORMED GARCIA BEDOYA THAT THE U.S. IS PROVIDING ALMOST THREE TIMES THE ASSISTANCE OF ALL TYPES FOR PERU IN FY 1978 AS IN FY 1975 (DOLLARS 52 MILLION IN 1975 HAVE RISEN TO PROJECTED DOLLARS 145 MILLION THIS YEAR) AND WE MAY BE ABLE TO DO MORE. WHILE BILATERAL AID PROGRAMS DO NOT GREATLY AFFECT THE IMMEDIATE SITUATION, THE USG AND PERU ARE ABOUT TO SIGN A DOLLARS 15 MILLION DEVELOPMENT LOAN AND ANOTHER IS IN PREPARATION. HE EXPRESSED THE BELIEF THAT DISCUSSIONS WOULD BE USEFUL CONCERNING THE TIMING OF THIS LOAN ANNOUNCEMENT IN ORDER TO DERIVE PSYCHOLOGICAL BENEFIT TO THE GOP PROGRAM.

7. BUSHNELL CONSIDERED IT DOUBTFUL THAT THE IDB WOULD ORGANIZE A DEBT RESCHEDULING PROCEDURE FOR PERU SINCE IT  
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HAS NEVER TAKEN SUCH ACTION BEFORE AND MIGHT FIND IT  
HARD TO LEAD SUCH A GROUP AND NOT RESCHEDULE ITSELF, BJT  
NOTED THAT THIS WAS A MATTER FOR GOP CONSULTATION WITH  
ORTIZ MENA. HE NOTED ON PERSONAL BASIS THAT HE WAS  
SYMPATHETIC TOWARD IDEA OF A RESCHEDULING MEETING BEING  
HELD IN ANOTHER CREDITOR CITY RATHER THAN PARIS AND  
STATED THAT HE WOULD EXPLORE WITHIN USG THE POSSIBILITY

OF A WASHINGTON (U.S.-CHAired) MEETING SHOULD THIS  
BECOME AN APPROPRIATE ALTERNATIVE AS ONE OF THE  
UNUSUAL STEPS WE MIGHT BE ABLE TO TAKE.

8. GARCIA BEDOYA DID NOT PROVIDE THE ANSWERS TO THE  
"QUESTIONNAIRE" WHICH HE WAS GIVEN PRIOR TO HIS DEPARTURE  
FOR LIMA, BUT SAID IT WAS BEING TRANSLATED AND WOULD BE  
PRESENTED ON APRIL 10. HE ALSO REQUESTED AN OPPORTUNITY  
TO FURTHER DISCUSS THE SITUATION WITH BUSHNELL NEXT  
WEEK AND BUSHNELL RESPONDED POSITIVELY.

9. APPRECIATE AMBASSADOR INFORMING FOREIGN MINISTER  
AND OTHER OFFICIALS AS APPROPRIATE OF U.S. VIEWS AS  
STATED ABOVE REPORTING THEIR REACTION INCLUDING  
INTENSITY THEIR INTEREST IN EARLY WASHINGTON VISIT. VANCE

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